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IN THE

Supreme Court of the United States

OCTOBER TERM, 1958

No. 909

GENERAL RETAIL CORPORATION (Delaware), *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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Internal Revenue Code of 1939, as amended by Excess Profits Tax Act of 1950 and Section 501, Revenue Act of 1951:

Section 430(a) 11a
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Section 445(g) 3, 4, 5, 6, 8, 9, 10, 13a
Section 503(a) 3, 4, 6, 7, 8, 10, 11, 15a

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Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Sixth Circuit entered in the above entitled cause January 2, 1959 (petition for rehearing denied February 11, 1959) affirming the decision of the Tax Court.

OPINION BELOW

The findings of fact and opinion of the Tax Court (Appendix A, *infra*, pp. 1a to 8a) are reported at 29 T.C. 632. The *per curiam* orders of the Court of Appeals affirming the decision of the Tax Court and denying the petition for rehearing have not yet been officially reported.

JURISDICTION

The judgment of the Court of Appeals was entered January 2, 1959, and order denying petition for rehearing was entered February 11, 1959. (Appendix A, *infra*, p. 10a). The jurisdiction of this Court is invoked under 28 U. S. C., sec. 1254.

QUESTION PRESENTED

Whether the constructive ownership rules of Section 503, Internal Revenue Code of 1939, (under which stock owned by a corporation is deemed to be owned proportionately by the stockholders of such corporation) should be imported into Section 430(e) so as to deny to a corporation the benefit of ceiling rates on Korean War excess profits taxes, to which it would otherwise have been entitled as a "new corporation."

STATUTE INVOLVED

The statutory provisions involved are Section 430(a) and (e), Internal Revenue Code of 1939; also Section 445(a) and (g), and Section 503(a). The pertinent portions are set forth in Appendix B, *infra*, pp. 10a to 15a.

STATEMENT

The facts are undisputed and are set forth in the opinion of the Tax Court, *General Retail Corporation (Delaware)*, 29 T. C. 632. Briefly stated, they are that petitioner, General Retail Corporation, was incorporated in 1948; that General Shoe Corporation, which had been in business since 1925, acquired for cash all its capital stock; and that petitioner purchased substantially all its assets from General Shoe Corporation at the latter's cost. In filing its income tax return for the taxable year ended October 31, 1951, petitioner computed its excess profits tax by using the ceiling

rates available to new corporations under Section 430 (e)(1), Internal Revenue Code of 1939, as amended.

The Commissioner of Internal Revenue determined a deficiency of $18,504.93, on the theory that because, under the constructive ownership rules of Section 503, Internal Revenue Code of 1939, the individuals who owned the capital stock of General Shoe Corporation also owned the capital stock of petitioner for the purposes of subparagraph (B) of Section 445(g)(2), these constructive ownership rules should also be applied for the purposes of clause (i) of Section 430(e)(2)(B) to the extent that transactions described in subparagraph (B) of Section 445(g)(2) are referred to; and that for this reason petitioner was barred from using the ceiling rates for new corporations. The Tax Court decided this issue of law in favor of the respondent, and the Court of Appeals affirmed.

The question involved is solely a question of statutory construction. It is petitioner's contention that Congress did not provide for the applicability of the constructive ownership rules of Section 503 to the factual situation here presented, and that the Tax Court indulged in judicial legislation when it held that they were applicable.

ARGUMENT

Before considering the exact language of Section 430(e), permitting new corporations, in computing excess profits taxes, to use ceiling rates which are graduated upwards in accordance with the number of years the corporation has been in business (the rate applicable to petitioner being 8%), it is necessary to consider Section 445(g), permitting new corporations to use an alternative average base period net income

computed by applying the average base period net income of return for the taxpayer's industry classification to the amount of its "total assets" and subtracting interest expense for twelve months. While both forms of so-called "relief" were made available by Congress to new corporations in general, certain classes of new corporations were made ineligible for the relief in each instance.

Paragraph (1) of subsection (g) of Section 445 denied the benefits of that Section (with certain specified exceptions) to corporations which had been parties to transactions described in paragraph (2) of subsection (g). One type of such transaction, described in subparagraph (B) of paragraph (2), was the acquisition of properties by the taxpayer from another corporation (not itself a new corporation), where 50% or more of the stock of each corporation was "owned directly or indirectly by the same individuals." Paragraph (3) of subsection (g) then went on to provide that "for the purposes of this subsection" the constructive ownership rules of Section 503 are applicable. This simply means, of course, that for the purpose of determining whether the new corporation was eligible to use the alternative average base period net income, the constructive ownership rules were to be applied. When Congress enacted Section 445(g), the second form of relief for new corporations provided in Section 430(e) had not yet been considered.

In the instant case, the petitioner, although organized in 1948, would not have been eligible to use the alternative average base period net income because General Shoe Corporation's stockholders were considered, under Section 503, to be the same as petitioner's stockholders. Petitioner is not, however, seeking the

right to use the alternative average base period net income for new corporations authorized by Section 445(g). What is involved in this case is the right to use the ceiling tax rates authorized by Section 430(e). This is a different type of relief for new corporations. It consists solely of a ceiling on the rate of the tax with respect to the first $300,000 of excess profits tax net income.

As in Section 445, certain classes of new corporations are ineligible to use the ceiling rates. Congress did not, however, provide that new corporations could qualify under Section 430(e) only if they could also qualify under Section 445. Under Section 445(g) the excess profits net income is less for a new corporation because its credit is greater, and the tax is less for that reason. On the other hand, under Section 430(e) the excess profits tax net income is the same, but the tax is less because the rate is less on the first $300,000 of excess profits tax net income. Some new corporations are entitled to the benefits of both relief provisions; some are entitled to benefits under one, but not the other; and some are not entitled to the benefits under either.

What the Tax Court and the Court of Appeals have done in this case is to hold that a new corporation which is ineligible under Section 445(g) is automatically ineligible under Section 430(e). If Congress had intended this result, it would have been easy for Congress to have said so. Congress could, indeed, have said so in such simple language that there could be no possible room for argument. But Congress deliberately did not do what the Tax Court says it intended to do.

Clause (i) of paragraph (2)(B) of Section 430(e) denies the benefits of the ceiling rates to any new corporation which had been a party to a transaction "described in section 445(g)(2)(A), (B), or (C) . . ." No reference is made either to paragraph (1) or to paragraph (3) of Section 445(g), and no reference is made to Section 503. Thus the effect of clause (i), to the extent that it adopts by reference the description in subparagraph (B) of paragraph (2) of Section 445 (g), is to deny the benefits of the ceiling rates where at least half of the new corporation's stock is owned by the same *individuals* who own at least half of the stock in an old corporation from which the new corporation acquired its assets; but the benefit of the ceiling rates is not denied to a new corporation simply because it acquired its assets from an old corporation which *itself* owns the stock of the new corporation.

Congress took the short cut of not repeating descriptions in paragraph (2) of Section 445(g), but of adopting those descriptions by reference. If Congress had repeated the descriptions verbatim, the constructive ownership rules of Section 503 would not have been applicable without an express statement to that effect. How then can it be said that they are applicable, without any express statement to that effect, merely because Congress adopted the descriptions by reference instead of repeating them verbatim?

To express the same thought somewhat differently, the draftsmen of clause (i) deliberately took out of context subparagraphs (A), (B) and (C) of paragraph (2) of Section 445(g) by omitting any reference to either paragraph (1) or paragraph (3) of subsection (g). By enacting clause (i) in this form, Congress excluded paragraphs (1) and (3) of subsection

(g), and by excluding paragraph (3), Congress excluded the constructive ownership rules of Section 503 from applicability.

Clause (ii) of paragraph (2)(B) of Section 430(e) clinches our argument. By this clause Congress made a new corporation ineligible where the same stockholders controlled both the new corporation and another corporation which was engaged in a similar business, provided that such control was vested in a group of not more than four persons. Control is defined to mean the ownership of more than 50 per centum of the stock. Whereas clause (i) did not mention, directly or indirectly, the constructive ownership rules of Section 503, the following statement is contained in clause (ii):

> "... . For the purpose of this clause, the ownership of stock shall be determined in accordance with the provisions of section 503, except that constructive ownership under section 503 (a)(2) shall be determined only with respect to the individual's spouse and minor children,"

There are two conclusions to be drawn from clause (ii). In the first place, the fact that Congress made the constructive ownership rules of Section 503 applicable for the purposes of clause (ii), but said nothing about them in connection with clause (i), furnishes strong support for the conclusion that Congress did not intend these constructive ownership rules to apply for the purposes of clause (i). In the second place, for Congress to say in clause (ii) that where the parent corporation is controlled by a group of not more than four persons, the subsidiary is ineligible (which is the result of applying the constructive ownership rules), is tantamount to saying that where the parent corporation is controlled by more than four persons an otherwise eligible subsidiary is still eligible.

The net effect of clauses (i) and (ii) is that a new corporation which is a wholly owned subsidiary of an old corporation is ineligible if (but *only* if): .....

> (1) its assets were acquired from the parent in a tax-free exchange;* or—
>
> (2) the subsidiary is engaged in a trade or business substantially similar to that of the parent, and a group of not more than four persons control the parent.**

In the instant case, petitioner is eligible because (1) there is no contention that it acquired assets from General Shoe Corporation in a tax-free exchange, and (2) there is no contention that General Shoe Corporation is controlled by a group of not more than four persons.

Strangely enough, at the same time that the Commissioner was litigating the instant case in the Tax Court, he was also litigating *Theatre Concessions, Inc. (Florida)*, in which a decision was rendered by the Tax Court on January 31, 1958, exactly one month after the decision in the instant case, involving facts substantially identical, so far as relevant to the issue here involved. *Theatre Concessions, Inc. (Florida)* is reported at 29 T. C. 754. Here again the Commissioner relied upon clause (i),—but instead of relying upon subparagraph (B) of Section 445(g)(2), the Commissioner relied upon subparagraph (A).

In *Theatre Concessions, Inc.*, as in the instant case, all the stock of the taxpayer corporation had been ac-

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* Clause (i) of Section 430 (e) (2) (B) by reference to subparagraph (A) of Section 445 (g) (2).

** Clause (ii) of Section 430 (e) (2) (B), applying the constructive ownership rules of Section 503, so that the persons who control the parent are considered to control the subsidiary also.

quired by its parent corporation for cash, and merchandise and supplies had been purchased from the parent corporation at the latter's cost. The Commissioner contended that petitioner's basis as to the merchandise and supplies thus acquired "is determined by reference to the basis of such [property] to the transferor" within the meaning of Section 445(g)(2)(A), and therefore, by virtue of Section 430(e)(2)(B)(i), the method of computing excess profits taxes provided by Section 430(e)(1)(A) was not available to petitioner. On this point, the Tax Court, speaking through Judge Kern, said:

> "With regard to respondent's first argument on this issue, we are of the opinion that the transaction here involved is not one described in section 445 (g) (2) (A). Petitioner's basis as to the merchandise and supplies purchased from Tallahassee Enterprises, Inc, was *its* cost. It is true that its cost was to be 'a sum equal to [the vendor's] costs for such merchandise and supplies,' but the fact that the price paid for merchandise is to be calculated with reference to the vendor's cost does not warrant a conclusion that its basis 'is determined by reference to the basis of such properties to the transferor.' We consider that the transactions referred to in section 445 (g) (2) (A) are among those particularized as exceptions to section 113 (a), and do not include a transaction in which the basis of the property is the cost to the acquiring corporation pursuant to section 113(a), even though that cost is calculated by reference to the cost of the vendor."

The second argument that the Commissioner made was that the alternative computation was not available to petitioner because of the provisions of Section 430(e)(2)(B)(ii). The petitioner had failed to prove

facts which would have taken it out of this exception. The proof was consistent with the theory that the parent corporation was controlled by not more than four persons and that the two corporations were engaged in a similar business. But the Commissioner had not made this contention at or before the hearing. The Tax Court held that the respondent should not be allowed to profit by this contention, based upon a failure of proof, because respondent advanced this theory for the first time, in his brief filed after the hearing of the case.

A circumstance in the *Theatre Concessions* case which we believe to be significant is that, although the Commissioner undertook to raise in his brief a new issue which had not been raised at or before the hearing, the Commissioner did not, even then, make the contention that is made by him in the instant case. Both cases were tried by attorneys working under the Regional Counsel in Atlanta, Georgia, and both cases were pending before the Tax Court at the same time. The only possible reason for the Commissioner's failure to rely upon subparagraph (B) of Section 445(g)(2) in the *Theatre Concessions* case was that the Commissioner did not consider the constructive ownership rules of Section 503 to be applicable with respect to clause (i) of Section 430(e)(2)(B).

The point decided against the petitioner in the instant case was decided in favor of the taxpayer by the District Court of the United States for the Western District of Texas February 24, 1958, in *Tuboscope Company* v. *Robert L. Phinney, District Director of Internal Revenue*. The District Director of Internal Revenue appealed the decision to the United States Court of Appeals for the Fifth Circuit, where the case has

been argued and is now under advisement (Docket No. 17,376). In the event of an affirmance there will be a conflict between the decision of the Court of Appeals in the instant case and the decision of another Court of Appeals on the same matter. The decision in the instant case was relied upon by the appellant in the *Tuboscope Company* case.

REASONS FOR GRANTING THE WRIT

It is believed that the Court of Appeals has decided an important question of federal law, which has not been, but should be, settled by this Court.

There are undoubtedly a number of corporate taxpayers whose excess profits tax liability under the Korean War excess profits tax law has not been settled, where the same question is involved. Beyond that, however, it is important to determine whether the constructive ownership rules of Section 503 are to be applied whenever the Commissioner of Internal Revenue thinks that they should be applied, even though Congress has not so provided and even though a "literal construction of [the] statute does no violence to common sense." (*Arroya* v. *United States*, decided May 4, 1959 by the Supreme Court of the United States.)

There is a conflict between the decision in the instant case by the Court of Appeals for the Sixth Circuit and the decision of a District Court in the Fifth Circuit, from which an appeal was taken and has been argued and submitted but not yet disposed of. It is assumed that the decision will be rendered before this petition is considered.

CONCLUSION

For the foregoing reasons this petition for a writ of certiorari should be granted.

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